TODAY'S MODEL CFO IN PRIVATE EQUITY:

A TRUE BUSINESS PARTNER

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ONE OF THE LEAST UNDERSTOOD AND MOST UNDERUTILIZED POSITIONS **IN AN ORGANIZATION** IS THAT OF THE CHIEF FINANCIAL OFFICER. FAR TOO MANY CEOS AND BOARDS FOCUS ON RECRUITING A CFO WHO IS A TECHNICAL WHIZ IN ACCOUNTING AND FINANCE, WHILE OVERLOOKING THE ROLE THE MOST-EFFECTIVE CFOS PLAY AS BUSINESS PARTNER AT THE SENIOR MANAGEMENT TABLE.

One of the wisest and most-effective CEOs and board members I've ever known talked about hiring a CFO in the same manner a President would think about selecting a vice presidential running mate. It was his view that, ideally, his CFO should be able to fill his seat in the event something happened to him. Not every CFO needs to be an heir apparent to the CEO, but it does put the importance of this position in proper perspective.

In any company, regardless of its size, there are a finite number of seats at the Executive Committee level. It is critically important that each executive in the room add significant value to the overall enterprise. For private equity firms, the importance of a true business partner is even more pronounced.

Ernst & Young's Global Private Equity Survey was published in the hopes of assisting CFOs to develop operating models that better position their firms to win by understanding the rapidly evolving link between companies and their investors. According to the report, the private equity landscape is vastly different from the recent past as stakeholders are pressing firms with inquiries regarding regulatory and operational risk management as well as the transparency of communications.

Investors have added a new layer - proven operational excellence – to their definition of "performance." To truly compete as best in class, private equity firms must now demonstrate that their front, middle and back offices all are operating effectively, as well as efficiently. CFOs that skillfully manage the inherent risks of rapid growth will become legitimate game changers and create competitive advantages for their organizations.

CFOs would be wise to make sure that they have the right policies and procedures in place – and the documentation to back them up. At the same time, CFOs are being asked to mitigate, if not eliminate, operating risks. Top among those risks is cybersecurity, which is a pressing issue for regulators, but even more urgent for the business: protecting confidential information involving investments, investors and the private equity firm itself.

> ***The mandate is clear: private equity firms that report in a transparent, timely and reliable fashion will demonstrate operational excellence. Reporting is more than the critical link between private equity firms and their investors; it's also the most prominent area for firms to gain a competitive advantage.***

As the burden of portfolio monitoring increases, the CFO and finance team are being asked to automate a process that, for many, is still spreadsheet-driven. Investors want granular information concerning valuations. They want detailed explanations of inputs, assumptions and formal approvals. In general, they want to increase their comfort level by developing a complete understanding of how private equity firms operate behind the scenes. Investors' desire for more robust customized reporting only increases the CFO's workload. Investors have little patience for information that moves slowly, with nearly all indicating they want quality data – fast. Three-quarters of investors want tax reporting within four months after year-end, an accomplishment that could place a private equity firm head and shoulders above the average. Overall, private equity firms expect requests for customized reports to increase with a premium in both quality and quantity. As a primary channel of communication with investors, CFOs who master the complexities of timely and transparent reporting have a right to celebrate a job well done.

Investor demands and requests of private equity firms engaged in due diligence will only increase; CFOs must optimally manage their teams to meet these rising expectations. This entails looking at new technologies and new processes, including outsourcing. Investors clearly expressed comfort with private equity firms moving to an outsourced model for tactical areas including tax and fund accounting. Investors would prefer compliance, investor relations, portfolio analysis and valuation to remain in-house, but are not against exploring them as third-party functions. For those functions that remain in-house, merely adding headcount will not address the capacity challenges at hand; technology solutions might.

Most understand that transparent and timely reporting is data-driven and process-oriented. The operations of private equity firms that are defined by superior management, data analytics and transparent presentations of timely information will find success. Unquestionably, innovation and optimization implemented according to each firm's needs and capabilities will allow businesses to scale, minimize resource constraints and enable CFOs to focus on strategic priorities.

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CFOs, in extending their focus, face a series of challenges. The first is infrastructure. The second, closely related, is resources. With spreadsheets and manual processes prevalent, private equity firms are generally limited in their ability to respond to the rising tide of reporting requests. With finance teams' headcounts not generally keeping pace with increases in responsibilities, implementing the right policies and procedures for given circumstances is likely to require a reallocation of resources – especially as assets under new management increase.

As private equity firms assume their role as the asset class of choice, the role of the CFO is exponentially growing more complex and important. CFOs have been tasked with optimizing traditional finance functions vital to the success of the firm and its' investors. CFOs have a mandate to extend their reach into the new definition of performance – one that is based on proven operational excellence. To conquer these formidable challenges, CFOs must move beyond tactical actions to strategic priorities. This year's survey reveals one area where investors and private equity firms agree: both value the CFO more than ever. We are convinced that CFOs will skillfully position their firms to win the competition for capital.

> *CFOs must be business partners to the CEO, board and private equity principals. Beyond track record, investors are most concerned with Clear Operational Strategy (64%), Team Stability (64%) Proven Operational Excellence (49%) General Partner Capital Commitment (13%) and Reporting (11%). Proven Operational Excellence and Reporting are typically driven by the finance team, while Strategy and General Partner Capital Commitment are usually the responsibility of the investment team. Team stability is usually shared by both teams.*

In addition to dealing with this increased complexity, CFOs must be strategic thinkers who help manage the business and offer leadership in addition to their financial expertise. The ability to influence and collaborate with the investment team emerges as a primary skill for PE CFOs. Experience in business units outside headquarters is often the best way for aspiring CFOs to sharpen their leadership and strategic skills.

To enjoy real influence, the CFO also requires credibility both inside and outside the firm. This involves building strong relationships with investors and opinion-leaders, as well as the CEO's other direct reports. The most effective CFOs think outside the box, outside the industry and certainly outside the departments for which they are personally responsible.

> ***Great CFOs also understand the concept of relationship capital within their own organizations. Often viewed as the fiduciary and steward of assets, CFOs must have the ability to form solid working and synergistic relationships with department heads throughout the organization. They must be viewed as partners with Operations, R&D, Marketing, Sales, Supply Chain, and Human Resources so that when they do have to use their veto power, they are not viewed as an impediment to driving revenues or improving business processes.***

The ability to monitor and communicate business results is a critical competency for top CFOs. Such leaders have a careful but entrepreneurial approach to risk. They can also talk about business models rather than financial statements and support their views with value indicators. The most effective CFOs, while executing flawlessly on the accounting, financial controls and modeling side of the equation, are equally supportive of corporate initiatives that build goodwill with all stakeholders.

Passion is an often an overlooked attribute of outstanding financial officers. Because the CFO role demands a healthy dose of objectivity and scrutiny, it might seem like passion is an unlikely trait of CFOs. Still, the most effective CFOs have a love and a passion for their profession, their companies and their industries. Although not advocating that a CFO must have in-depth knowledge of a particular industry sector when entering a company. I am saying that in order to achieve maximum effectiveness, the CFO must have a clear understanding of the strategy and appreciation of the business in which they operate. They should find the business interesting and understand what critical success factors drive the enterprise.

Despite their well-developed relationships with other executives on the management team, objectivity and independence remain core values for senior financial leaders. CFOs are the guardians of good business practices and controls. It is also their job to troubleshoot and manage the risks inherent in corporate strategies, but guard against the tendency to use their veto power to stop initiatives just because they are risky. Achieving the right degree of independence and collaboration is a tough balancing act which is why some of the most-successful CFOs have experience in line and staff roles, enabling them to perfect both sets of skills.

Outstanding CFOs with all of these skills and the right personal chemistry with their CEO have the ability to become his/her right-hand person. Ultimately, such CFOs become agents of change, creating smarter work patterns throughout their organization with insights that drive performance and help achieve better results. However, only the most-talented financial executives can succeed in such a demanding role. It may seem like a daunting task, since financial leaders with these capabilities are in short supply. For those companies who want to harness the power of a strong CEO/CFO partnership, developing or finding such talent is worth the effort.